Trust Strategy

Impactful Giving to Reduce Taxes and Transfer Assets

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Individuals with significant tax events may face minimal opportunities for deductions or credit. A Charitable Split-Interest trust can be a possible solution.

Individuals with significant tax events such as substantial capital gains from the sale of a business or other assets often face minimal opportunities for deductions or credits as a result of the 2017 Tax Cuts & Jobs Act. Also, many households want to use those gains to provide support to charities and leave assets to family members and other beneficiaries.

In these situations, a charitable annuity lead trust (CLAT) may be an ideal solution.

Potential Strategy

A charitable lead trust enables a household to make gifts to charities from assets for a period of time, with any remaining assets to go to beneficiaries at the end of that period. To understand how a CLAT works, consider the example of a high-earning 65-year-old couple faced with a potential $2 million gain from the sale of a business interest in 2020.

With the federal capital gains tax of 20% and the net investment income surtax of 3.80%, federal taxes (ignoring AMT) are $476,000. This total does not include state income taxes, which range from 0% to 13.3%. A $1 million gift to a charitable lead annuity trust in the current year could materially reduce this income tax burden.

The three steps involved are straightforward:

1. First, the couple donates the property to the trust and decides on the annual payment. For example, if a 5% payout rate is selected, the trust pays out $50,000 per year -– a set annuity -– to the charities of the couple's choice for the remainder of their lives.
2. The couple receives an income tax deduction of almost $900,000. This deduction reduces their federal income tax by over $214,000 -– nearly one-half of the tax would otherwise have to be paid.
3. The remainder interest (if any) at the second spouse's death reverts to the couple's children outright or in a trust.

Benefits

Charitable lead annuity trusts can:

- Afford clients the potential for significant income tax deductions.
- Have a considerable degree of flexibility concerning term and payout. For example, you could structure a CLAT as described above to last for 10 or 20 years instead of life, although the tax benefit shrinks.
- Reduce a client's taxable estate by the present value of the charitable annuity payments, discounted at a rate set by the IRS. This rate is currently very low, which means the estate tax benefits heighten.

Outcomes

Next-generation beneficiaries can receive assets outright or in an irrevocable trust for their benefit for an indeterminate (life) or finite (term of years) period. If the CLAT grantor doesn't need current income, the remainder can pass to family members. With a grantor CLAT (the most common type), the grantor retains responsibility for taxes on trust assets.

We typically recommend engaging with an experienced advisor and fiduciary who can guide the process and structure the trust to maximize benefit both for your estate and the favorite charities.

For more information, please contact your Key Private Bank Advisor.

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